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SUBJECT: EFFECT OF GLOBAL FINANCIAL CRISIS ON NEW ZEALAND'S
ECONOMY

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11. (U) Summary: New Zealand is not totally immune to the global credit crisis with the first visible signs being manifested in the NZ\$260 million loss (4.9 percent) in value of the country's Superannuation Fund due in large part to its fifty percent exposure to international equities market. The Reserve Bank of New Zealand (RBNZ) continues to reassure the public that NZ's financial sector remains sound while it prepares to explore new ways to underpin banks and ensure sufficient liquidity in the financial system. Prime Minister Helen Clark announced on October 12 that the GNZ would provide an unprecedented safeguard scheme for an opt-in guarantee plan that covers deposits for New Zealand-registered banks and eligible non-bank depositors (including banking societies, credit unions and finance companies) with the cost amounting to NZ\$150 billion. However, NZ banks are in the unique position of having four of the top twenty banks worldwide with the highest credit ratings operating in its domestic market (all Australian owned). Although there are eighteen registered banks operating in New Zealand, eighty-five percent of New Zealand's bank assets are owned by these top four Australian banks. In the 2008/09 Global Competitiveness Report published by the World Economic Forum (Davos), New Zealand was assessed as the eighth most secure country in terms of the strength of its investor protection. This ranking has not prevented the New Zealand business community from proposing changes in both fiscal and monetary policy which they hope will prevent the country from being buffeted by the global financial crisis. End Summary.

First Signs of Trouble

12. (U) New Zealand's first visible sign that the turmoil in the world's financial markets has had any negative impact domestically came with the announcement in the 2008 annual report (ending June) for NZ's Superannuation Fund. The Fund is reporting a loss of NZ\$260 million or negative return of 4.9 percent. The Fund was created to partially provide for the future costs of funding NZ's pension scheme for public servants. The Fund began investing in 2003 with an initial deposit of NZ\$2.4 billion of Crown money. As of August, the Fund's assets totaled NZ\$4.5 billion. About half of the Fund is invested in international shares and a quarter invested in fixed interest investments with the remainder invested in NZ shares, property and commodities. Fund returns on NZ shares fell by 22 percent and the world shares fell 12 percent (at time of report).

The Fund's manager, Alan Langford, said there were no plans at this time to decrease the NZ\$3.6 billion Fund's exposure to the equity markets. Payouts to recipients are fixed by law and to date will not be affected by loss. The Fund's managers remain optimistic that their investment strategy will weather the storm.

Reserve Banks Reassures Public

13. (U) The Reserve Bank of New Zealand (RBNZ) issued its October report saying that the NZ financial sector remained sound. RBNZ Governor Alan Bollard said in a press statement that "although the domestic situation may have been exacerbated by the recent failure of many domestic finance companies (non-bank building and loans organizations) - withdrawn money (from the finance companies) has flowed back into (regulated) banks as deposits." Bollard further said, "We believe the NZ banking system remains robust and the RBNZ was in ongoing dialogue with banks and monitoring their positions closely." Bollard did say that although disruptions in the U.S. markets were reverberating around the world, New Zealand banks are not directly involved. Bollard said that while New Zealand will inevitably feel some effects of the major global financial shocks, New Zealand banks are not involved in the sort of complex financial transactions that have caused significant losses in many of the large global institutions. ConGen Auckland's banking contacts confirmed that, compared to U.S. banks, NZ banks are "old fashioned." Fifty percent or more of the assets on the balance sheets of NZ's big banks are mortgages, a significantly higher percentage than in the U.S. Furthermore, NZ mortgage lending is conservative, with the sort of sub-prime lending seen in the U.S. nearly unheard of in NZ.

RBNZ Measures to Secure Domestic Banks' Liquidity

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14. (U) The RBNZ will release soon a consultation document on a proposed policy revision for domestic banks in regards to the management of their own liquidity and funding. The proposed policy changes are aimed at ensuring that the banks are less vulnerable to future liquidity shocks and disruptions in global financial markets. "While these measures will assist in promoting a more stable liquidity situation, the Reserve Bank maintains its full confidence in the (current) underlying solvency of the New Zealand banking system," announced Deputy RBNZ Governor Grant Spencer.

15. (U) The Reserve Bank intends to make certain Asset Backed Securities ("ABS" - e.g., home equity loans, auto loans and credit card payments) eligible as collateral in its domestic liquidity facilitation. RBNZ will also, if required, be prepared to lend on the basis of fully-secured Residential Mortgage-Backed Securities (RMBSs), prior to those securities achieving formal ratings" said Bollard. He believes there has been good progress by financial institutions in developing RMBSs should they be needed and went on to say, "while we believe these measures are sufficient at this stage, the Bank retains a number of other regulatory powers - we are committed to ensuring the ongoing health of the financial system and remain ready to respond as appropriate." The proposed terms for this plan will be subject to industry consultation before they are finalized according to the Deputy Governor. One Auckland banker, a representative of one of the big four banks, reports that his institution will be ready within days to sell off to the RBNZ a significant block of RMBSs.

FM Cullen on the Global Credit Crisis

16. (U) Finance Minister Cullen reacted to the global credit crisis, saying there were still real risks of serious harm to the New Zealand economy but noted that the Australian-owned banks operating in NZ (which comprise the greatest market share of NZ financial institutions) had little exposure to the United States sub-prime mortgage crisis. Cullen said that four of the top 20 banks worldwide with the highest credit ratings were Australian owned and that included the Bank of New Zealand (Australian parent), ASB,

ANZ-National and Westpac. (Note: There are 18 registered banks operating in New Zealand but 85 percent of New Zealand's bank assets are owned by the top four Australian banks listed above. End note).

He echoed Bollard's comments in noting that the earlier collapse of several NZ finance companies had driven New Zealanders to shift deposits to sounder banks, sending household deposits soaring by NZ\$10 billion over the past year to nearly NZ\$85 billion. Cullen said he believed that both New Zealand and Australia's banking systems were sound and would emerge from the crisis in better shape than many others around the world.

Prime Minister Guarantees Bank Deposits

17. (U) But fearing that the spreading global financial crisis may directly affect the domestic financial market, Prime Minister Helen Clark announced Sunday, October 12 an unprecedented safeguard scheme for an opt-in deposit guarantee plan that covers deposits for New Zealand-registered banks and eligible non-bank deposit-takers (including banking societies, credit unions and finance companies). "The purpose of the scheme is to assure New Zealand depositors that they can be assured their deposits are quite safe and the New Zealand financial system is sound," said PM Clark. The GNZ will make payment in the event of the liquidation of a guaranteed financial institution, if its assets are shown to be insufficient to meet the liabilities covered by this guarantee. It is estimated that the cost of the scheme to the GNZ will add about NZ\$150 billion as a contingent liability but the GNZ is adamant that NZ banks are sound, so there is no danger that it will have to pay out.

Details of the Deposit Guarantee

18. (U) Under the terms of the Public Finance Act, the GNZ will invite eligible institutions to offer a guarantee of their deposit liabilities. Eligible financial institutions must be New Zealand registered banks and non-bank deposit-taking financial institutions, who are fully compliant with the requirements of their trust deeds. For New Zealand incorporated registered banks deposits from both

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residents and non-residents, will be covered. For non-bank deposit takers and for the unincorporated branches of overseas entities only deposits of New Zealand citizens and New Zealand tax residents will be covered. Deposit liabilities will be covered regardless of the currency in which they are denominated. Deposits and other liabilities owed to financial institutions, whether in NZ or offshore, are explicitly excluded from this guarantee. The guarantee will be offered for a term of two years. The scheme will be free for institutions with total retail deposits under NZ\$5 billion. A fee of ten basis points per annum will be charged on total deposits above NZ\$5 billion. This means that a bank with NZ\$20 billion in retail deposits would pay NZ\$15 million in fees per annum. While there is no direct fee for individuals charged by the GNZ, financial institutions will determine if and how the costs of the scheme are to be passed on. The scheme does not apply retrospectively and therefore offers no relief for those investors who may have suffered losses prior to the announcement.

Reaction

19. (U) After the Prime Minister's announcement, the four largest big trading banks, ANZ-National, BNZ, ASB and Westpac, joined TSB, SBS Bank and government-owned Kiwibank in confirming their commitment to the scheme .but the blanket guarantee is already drawing criticism. There are concerns it will, in effect, encourage a shift in savings away from banks to non-bank finance companies, whose offers of higher returns on riskier investments might be harder to resist if they came with a government safety net. This concern is driven in large part by the fact that more than 20 non-bank finance companies in New Zealand have failed over the past two years with around NZ\$5 billion of investors' funds that have been frozen or negotiated to drip feed money owed to them. Of the gigantic sum not yet paid back, a large chunk between NZ\$320 and NZ\$785 million looks to be lost for good, based on estimates

provided by receivers and those companies that received the go-ahead to carry on trading. (Note: The losses brought about by the collapse of these NZ finance companies is not directly tied to the sub-prime mortgage market in the U.S. ,but as credit became tighter internationally the structural problems faced by these institutions were exacerbated. End Note.)

Independent Assessment of NZ Banks' Viability

¶10. (U) In section eight of the 2008/09 Global Competitiveness Report published by the World Economic Forum (Davos), there is a survey of the level of financial market sophistication of 134 countries. The report attempts to capture the opinion of business leaders throughout the world concerning the many economic factors that impact the environment in which businesses operate which in turn dictates the competitiveness of a nation's economy. In section 8.07 of the report dedicated to the soundness of banks in the respective countries and graded on a scale of 1 (insolvent) to 7 (healthy with sound balance sheets), New Zealand scored 6.6. Rank-ordered Canada was listed first with a score of 6.8, New Zealand ranked 8 scoring 6.6 and the United States ranked 40 with a score of 6.1. In section 8.06 of the report, which ranks countries by strength of investor protection on a scale of zero (worse) to ten (best), New Zealand was in first place with a score of 9.7 and the United States ranked 5 with a score of 8.3.

Reaction to Tighter International Credit Markets

¶11. (SBU) A senior officer of a multinational investment bank located in Auckland said to the Consul General that New Zealand banks depend on the international capital markets for as much as half of their funding. According to media reports, local banks are on the hook to repay NZ\$60 billion (US\$36 billion) to international creditors within the next 40 days, debt that in the past they could have rolled over. The banks will count on the kind of RBNZ help described above to help them meet these obligations. Banks will also turn to cost cutting, said the executive. ANZ Bank - New Zealand has already announced a hiring freeze, a review of its branch structure with a view to reducing staff, and an offer of voluntary redundancies.

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¶12. (SBU) At the same time that bank liquidity is tightening, bank customers are asking more of their banks. An officer of one of NZ's big banks told the CG that because the commercial paper market has frozen, customers that traditionally took care of their own short-term cash needs are now coming to him for help. With global money markets frozen and local demand for short-term credit increasing, this banker reports that his institution is no longer seeking new business, but focusing its limited resources on serving its current customers. His customers complain that tight credit is starting to ripple through supply relationships. Many suppliers, even ones with long-standing customers to whom they traditionally extended generous terms are reducing the period they are willing to sell on an account. Some are even demanding cash on delivery not just from new clients, but from customers they've had profitable relationships with for years.

¶13. (SBU) New Zealanders' confidence in their banks is still high, but there are signs that depositors are getting edgy. CG's bank contacts passed on reports that Kiwibank has seen an uptick in deposits in recent days and has concluded the money is coming from customers seeking the reassurance of that implicit guarantee. One banker pointed to the reaction to a September 30 computer glitch at one of the other big four banks as a sign of how jittery customers have become. The glitch delayed transfer of funds to big customers just as they were trying to make monthly payroll. Such incidents have happened in the past at many banks, the banker said, and have generated nothing more than frustration and embarrassment. This time, however, the banker received calls from that bank's customers asking if the bank was going under.

NZ Business Leaders' Reaction to Credit Crisis

¶14. (U) Earlier this month, a panel of experts consisting of businessmen, academics and journalists gathered at a prominent Wellington law firm Bell Gully for a symposium entitled "Perspectives on the Economy" to discuss how the current global financial crisis may impact the NZ economy. Stephen Toplis, chief economist at the Bank of New Zealand, opined that while most experts are still unsure what direct long-term impacts the global credit crisis will have on NZ's financial markets, the near-term damage should be relatively minimal. Toplis said that while NZ's exposure to the U.S. derivatives and sub-prime mortgage markets was negligible, NZ banks do remain overleveraged and exposed because of imbalances in NZ's domestic housing market. Several analysts noted that one of the biggest potential problems facing the NZ economy was its vulnerability as a single/limited commodity exports (dairy, meat and agriculture) driven economy. Without a more diversified economy NZ will remain precariously overexposed to downturns in demand in the global markets.

Think Tank Offers Strategy to Protect NZ Economy

¶15. (U) In a draft report, released October 10, David Skilling CEO of the New Zealand Institute and Mark Weldon CEO of the New Zealand Stock Exchange (NZX) said the current global financial crisis is one of the most serious events the New Zealand economy has faced in decades and New Zealand's response to the crisis needed to be "deliberate, serious and proportionate" calling for immediate, bipartisan action as needed to ensure that New Zealand not only survives the crisis, but thrives under the emerging economic storm conditions." Skilling and Weldon further said, "We believe there is little we can do about Northern Hemisphere banks, there is a lot we can do to determine how well the New Zealand economy copes with permanent changes to global credit markets and a global economic slowdown." The report suggested some economic measure which could reduce NZ's economic vulnerability including: provisional tax payments (provisional tax is a way of paying income tax throughout the year) be deferred for 24 months, capital investment be "prioritized with incentives," a two-year income cap tax at 20 percent for New Zealanders returning home, firms be attracted to New Zealand with two years of no corporate tax and the Research and Development tax credit be retained. In the longer term, the report said a company should be created to manage commercial state-owned enterprises (SOE), a taxpayer savings vehicle should be created to manage financial assets, KiwiSaver be made compulsory and the biases in the tax code that promote housing speculation be removed.

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Comment

¶16. (SBU) Prime Minister Helen Clark's dramatic move over the weekend to insure bank deposits (a move that mirrored the Australian Government) was a dramatic signal at the kick-off of her re-election campaign to reassure the country's voters that her government (along with the Reserve Bank) was prepared to take all necessary measures to ensure the safety of the NZ financial system. While our contacts in government, business and academia remain concerned about the long-range impact of the international financial crisis on New Zealand's economy, they believe the crisis will be mitigated because the domestic banking system is conservative and the RBNZ is in the right position to respond effectively. The typical New Zealander's primary investment tends to be their house, rather than shares, so gyrations on the international stock markets are not as unnerving for Kiwis as they are for Americans. Also, the commodity sector (dairy and agriculture), the engine of New Zealand exports, is expected to remain strong even if prices do fall from recent record-setting levels. These same contacts tend to view the international financial situation not as a crisis for New Zealand in itself but as a factor that will aggravate the current domestic recession. Whether the recession will now be longer and more painful than it otherwise would have been, Kiwis still believe the NZ economy is better positioned than most to weather the storm. End Comment.

